

ATTACHMENT F
WORLDCOM'S FORM 10-K FOR 2001

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-K

(Mark One)

☐ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2001

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 0-11258

WorldCom, Inc.

(Exact name of registrant as specified in its charter)

Georgia

58-1521612

(State or other jurisdiction of incorporation or
organization)

(I.R.S. Employer Identification No.)

500 Clinton Center Drive, Clinton, Mississippi
(Address of principal executive offices)

39056

(Zip Code)

(601) 460-5600

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

WorldCom group Stock, \$.01 Par Value

MCI group Stock, \$.01 Par Value

Rights to Purchase Series 4 Preferred Stock

Rights to Purchase Series 5 Preferred Stock

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 28, 2002 was:

WorldCom group Stock, \$.01 par value: \$22,156,502,684

MCI group Stock, \$.01 par value: \$810,400,477

Common shares outstanding as of February 28, 2002, net of treasury shares:

WorldCom group Stock: 2,962,645,459

MCI group Stock 118,325,109

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement of the registrant for the registrant's 2002 Annual Meeting of Shareholders, which definitive proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the registrant's fiscal year end of December 31, 2001, are incorporated by reference into Part III.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The following statements are or may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995:

- (i) any statements contained or incorporated herein regarding possible or assumed future results of operations of WorldCom's business, anticipated cost savings or other synergies, the markets for WorldCom's services and products, anticipated capital expenditures, the outcome of euro conversion efforts, regulatory developments or competition;
- (ii) any statements preceded by, followed by or that include the words "intends," "estimates," "believes," "expects," "anticipates," "should," "could," or similar expressions; and
- (iii) other statements contained or incorporated by reference herein regarding matters that are not historical facts.

Because such statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements; factors that could cause actual results to differ materially include, but **are** not limited to:

- economic uncertainty;
- the effects of vigorous competition;
- the impact of technological change on our business, alternative technologies, and dependence on availability of transmission facilities;
- risks of international business;
- regulatory risks in the United States and internationally;
- contingent liabilities;
- uncertainties regarding the collectibility of receivables;
- risks associated with debt service requirements and our financial leverage;
- uncertainties associated with the success of acquisitions;
- the ongoing **war** on terrorism; and
- the other risks referenced from time to time in WorldCom's filings with the Securities and Exchange Commission.

Potential purchasers of WorldCom capital stock are cautioned not to place undue reliance on such statements, which speak only *as* of the date thereof.

The cautionary statements contained or referred to in this section should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by WorldCom or persons acting on its behalf. We undertake no duty to update these forward-looking statements, even though our situation may change in the future.

PART I

ITEM 1. BUSINESS

General

Organized in 1983, WorldCom, Inc., a Georgia corporation, provides a broad range of communications services to both U.S. and non-U.S. based businesses and consumers. We are a global communications company utilizing a strategy based on being able to provide service through our own facilities throughout the world instead of being restricted to a particular geographic location. We call this our "on-net" strategy. The on-net approach allows our customers to send data or voice communications across town, across the U.S., or to any of our networks in Europe or Asia, often without ever leaving our networks. The on-net approach provides our customers with superior reliability and low operating costs. Our core business is communications services, which includes voice, data, Internet and international services.

On June 7, 2001, our shareholders approved a recapitalization involving the creation of two separately traded tracking stocks:

- WorldCom group stock, which is intended to reflect the performance of our data, Internet, international and commercial voice businesses and is quoted on The Nasdaq National Market under the trading symbol "WCOM", and
- MCI group stock, which is intended to reflect the performance of our consumer, small business, wholesale long distance voice and data, wireless messaging and dial-up Internet access businesses and is quoted on The Nasdaq National Market under the trading symbol "MCIT".

In connection with the recapitalization, we amended our articles of incorporation to replace our existing common stock with two new series of common stock that are intended to reflect, or track, the performance of the businesses attributed to the WorldCom group and the MCI group. Effective with the recapitalization on June 7, 2001, each share of our existing common stock was changed into one share of WorldCom group stock and 1/2s of a share of MCI group stock.

A tracking stock is a separate class of a company's common stock intended to provide a return to investors based upon the financial performance of a distinct business unit of the company, sometimes referred to as the targeted business. These targeted businesses are collections of businesses that we have grouped together in order for us to issue WorldCom group stock and MCI group stock. The ownership of the targeted business does not change, and while each of the classes of stock trade separately, all shareholders are common shareholders of a single company, WorldCom, and are subject to all risks of an investment in WorldCom as a whole.

During the second quarter of 2001, we declared the initial quarterly dividend for the MCI group stock. A cash dividend of \$0.60 per share of MCI group stock, or approximately \$70 million in the aggregate, was paid on October 15, 2001 to shareholders of record as of the close of business on September 28, 2001. Dividends of \$0.60 per share of MCI group stock were also declared during the third and fourth quarters of 2001 which have been or will be paid in 2002.

The MCI group was initially allocated notional debt of \$6 billion and our remaining debt was allocated on a notional basis to the WorldCom group. We intend, for so long as the WorldCom group stock and the MCI group stock remains outstanding, to include in our filings under the Securities Exchange Act of 1934, as amended, the combined financial statements of each of the WorldCom group and the MCI group. These combined financial statements will be prepared in accordance with accounting principles generally accepted in the United States, and in the case of annual financial statements, will be audited. These combined financial statements are not legally required under current law or SEC regulations.

Voting rights of the holders of the WorldCom group stock and the MCI group stock are prorated based on the relative market values of WorldCom group stock and MCI group stock. We will conduct shareholder meetings that encompass all holders of voting stock. The WorldCom group and the MCI

group shareholders will vote together as a single class on all matters brought to a vote of shareholders, including the election of our directors.

Our board of directors may at any time convert each outstanding share of MCI group stock into shares of WorldCom group stock at 110% of the relative trading value of MCI group stock for the 20 days prior to the announcement of the conversion. No premium will be paid on a conversion that occurs after June 7, 2004.

If all or substantially all of the WorldCom group or MCI group assets are sold, either: (i) the relevant shareholders will receive a distribution equal to the fair value of the net proceeds of the sale, either by special dividend or by redemption of shares; or (ii) each outstanding share of MCI group stock will be converted into shares of WorldCom group stock at 110% or 100% of the relative trading value of MCI group stock for a 10 trading day period following the sale.

We serve as a holding company for our subsidiaries' operations. References herein to WorldCom, "we," "our," or "us" include WorldCom, Inc. and our subsidiaries, unless the context otherwise requires. Additionally, information in this document has been revised to reflect the stock splits of our common stock.

Business Combinations

Intermedia. On July 1, 2001, we acquired Intermedia Communications Inc. for approximately \$5.8 billion, including assumed long-term debt, pursuant to the merger of a wholly owned subsidiary with and into Intermedia, with Intermedia continuing as the surviving corporation and as a subsidiary of WorldCom. As a result of the Intermedia merger, we acquired a controlling interest in Digex, Incorporated, or Digex, a provider of managed Web and application hosting services. In connection with the Intermedia merger, stockholders of Intermedia received one share of WorldCom group stock (or 57.1 million WorldCom group shares in the aggregate) and $\frac{1}{25}$ of a share of MCI group stock (or 2.3 million MCI group shares in the aggregate) for each share of Intermedia common stock they owned. Holders of Intermedia preferred stock, other than Intermedia's 13.5% Series B Redeemable Exchangeable Preferred Stock due 2009, or Intermedia Series B Preferred Stock, received one share of a class or series of our preferred stock, with substantially identical terms, which were established upon consummation of the Intermedia merger. As a result of the merger with Intermedia, we own approximately 90% of the voting securities of Intermedia.

Upon effectiveness of the merger with Intermedia, the then outstanding and unexercised options for shares of Intermedia common stock were converted into options exercisable for an aggregate of approximately 10 million shares of WorldCom group stock having the same terms and conditions as the Intermedia options, except that the exercise price and the number of shares issuable upon exercise were divided and multiplied, respectively, by 1.0319. The merger with Intermedia was accounted for as a purchase.

The purchase price in the Intermedia merger was allocated based on appraised fair values at the date of acquisition. This resulted in an excess purchase price over net assets acquired of \$5.1 billion of which \$67 million was allocated to customer lists, which will be amortized over approximately four years on a straight line basis. The remaining excess of \$5.0 billion has been allocated to goodwill and tradename which are not subject to amortization and the goodwill is not expected to be deductible for tax purposes.

In connection with the Intermedia merger, the Antitrust Division of the Department of Justice required us to dispose of Intermedia's Internet service provider business, which provided integrated Internet connectivity solutions and effective December 1, 2001, we sold substantially all of the Internet related assets for approximately \$12 million. In addition to this required divestiture, we also committed to a plan to sell Intermedia's Advanced Building Network business, which provides centralized telecommunications services in multi-tenant commercial office buildings, and the systems integration business through which Intermedia sells, installs, operates and maintains business telephony customer premise equipment for its customers. We included the appraised fair values of these assets to be

disposed of in our initial allocation of the Intermedia purchase price and also included accrued anticipated losses expected to be incurred through disposal date. Any difference between the actual results of operations and the amounts accrued will result in an adjustment of goodwill unless there is a difference resulting from a post-merger event. We anticipate that we will complete the planned disposals of the remaining identified businesses before the third quarter of 2002.

Since the Intermedia merger, we initiated plans to improve cash flow and operating results by reorganizing and restructuring Intermedia's operations. These plans include workforce reductions and other administrative cost savings, the discontinuance of all product lines with unacceptable or negative margins and the ultimate disposal of **all** assets associated with such product lines or businesses.

SkyTel Communications. On October 1, 1999, we acquired SkyTel Communications, Inc., pursuant to the merger of SkyTel with and into a wholly owned subsidiary of WorldCom. Upon consummation of the SkyTel merger, the wholly owned subsidiary was renamed SkyTel Communications, Inc. SkyTel is a leading provider of nationwide messaging services in the United States. SkyTel's principal operations include one-way messaging services in the United States, advanced messaging services on the narrow band personal communications services network in the United States and international one-way messaging operations.

As a result of the SkyTel merger, each outstanding share of SkyTel common stock was converted into the right to receive 0.3849 shares of WorldCom common stock, par value \$.01 per share, or approximately 23 million WorldCom common shares in the aggregate. Holders of SkyTel's \$2.25 Cumulative Convertible Exchangeable Preferred Stock received one share of WorldCom Series C \$2.25 Cumulative Convertible Exchangeable Preferred Stock for each share of SkyTel preferred stock held. The SkyTel merger was accounted for **as** a pooling-of-interests; and accordingly, our financial statements for periods prior to the SkyTel merger have been restated to include the results of SkyTel.

MCI. On September 14, 1998, we acquired MCI Communications Corporation for approximately \$40 billion, pursuant to the merger of MCI with and into a wholly owned subsidiary of WorldCom. Upon consummation of the MCI merger, the wholly owned subsidiary was renamed MCI Communications Corporation. MCI became a wholly owned subsidiary of WorldCom. Through the merger with MCI, we acquired one of the world's largest and most advanced digital networks, connecting local markets in the United States to more than 280 countries and locations worldwide.

As a result of the merger with MCI, each outstanding share of MCI common stock was converted into the right to receive 1.86585 shares of WorldCom common stock or approximately 1.13 billion WorldCom common shares in the aggregate, and each share of MCI Class **A** common stock outstanding (all of which were held by British Telecommunications plc) was converted into the right to receive \$51.00 in cash or approximately **\$7** billion in the aggregate. The funds paid to British Telecommunications were obtained by WorldCom from (i) available cash as a result of our \$6.1 billion public debt offering in August 1998; (ii) the sale of MCI's Internet backbone facilities and wholesale and retail Internet business to Cable and Wireless plc for \$1.75 billion in cash on September 14, 1998; (iii) the sale of MCI's 24.9% equity stake in Concert Communications Services to British Telecommunications **for** \$1 billion in cash on September 14, 1998; and (iv) availability under our commercial paper program and credit facilities.

Upon effectiveness of the merger with MCI, the then outstanding and unexercised options exercisable for shares of MCI common stock were converted into options exercisable for an aggregate of approximately 125 million shares of WorldCom common stock having the same terms and conditions as the MCI options, except that the exercise price and the number of shares issuable upon exercise were divided and multiplied, respectively, by 1.86585. The merger with MCI was accounted for as a purchase.

Embratel. On August 4, 1998, MCI acquired a 51.79% voting interest and a 19.26% economic interest in Embratel **Participações S.A.**, Brazil's facilities-based national **and** international communications provider, for approximately R\$2.65 billion (U.S. \$2.3 billion). The purchase price was

paid in local currency installments, of which R\$1.06 billion (U.S. \$916 million) was paid on August 4, 1998, R\$795 million (U.S. \$442 million) was paid on August 4, 1999, and the remaining R\$795 million (U.S. \$444 million) was paid on August 4, 2000. Embratel provides domestic long distance and international telecommunications services in Brazil, as well as over 40 other communications services, including leased high-speed data, Internet, frame relay, satellite and packet-switched services. Operating results for Embratel were consolidated in our accompanying consolidated financial statements from the date of the MCI merger through 2000.

During the second quarter of 2001, we reached a long-term strategic decision to restructure our investment in Embratel. The restructuring included the resignation of certain Embratel board of directors seats, the irrevocable obligation to vote a portion of our common shares in a specified manner and the transfer of certain economic rights associated with such shares to an unrelated third party. Based on these actions, the accounting principles generally accepted in the United States prohibit the continued consolidation of Embratel's results. Accordingly, we have deconsolidated Embratel's results effective January 1, 2001.

CompuServe. On January 31, 1998, WorldCom acquired CompuServe Corporation for approximately \$1.3 billion, pursuant to the merger of a wholly owned subsidiary of WorldCom, with and into CompuServe. Upon consummation of the merger with CompuServe Corporation, CompuServe Corporation became a wholly owned subsidiary of WorldCom.

As a result of the merger with CompuServe Corporation, each share of CompuServe Corporation common stock was converted into the right to receive 0.609375 shares of WorldCom common stock or approximately 56 million WorldCom common shares in the aggregate. Prior to the merger with CompuServe Corporation, CompuServe Corporation operated primarily through two divisions: Interactive Services and Network Services. Interactive Services offered worldwide online and Internet access services for consumers, while Network Services provided worldwide network access, management and applications, and Internet services to businesses. The merger with CompuServe Corporation was accounted for as a purchase.

ANS. On January 31, 1998, we also acquired ANS Communications, Inc. from America Online, Inc. for approximately \$500 million, and entered into five year contracts with AOL under which WorldCom and its subsidiaries provide network services to AOL. Additionally, AOL acquired CompuServe's Interactive Services division and received a \$175 million cash payment from WorldCom. WorldCom retained the CompuServe Network Services division. ANS provided Internet access to AOL and AOL's subscribers in the United States, Canada, the United Kingdom, Sweden and Japan. The transaction with AOL was accounted for as a purchase.

Brooks Fiber Properties. On January 29, 1998, WorldCom acquired Brooks Fiber Properties, Inc. pursuant to the merger of a wholly owned subsidiary of WorldCom, with and into Brooks Fiber Properties. Upon consummation of the merger with Brooks Fiber Properties, Brooks Fiber Properties became a wholly owned subsidiary of WorldCom. Prior to the merger, Brooks Fiber Properties acquired and constructed its own state-of-the-art fiber optic networks and facilities and leased network capacity from others to provide long distance carriers, Internet Service Providers, wireless carriers and business, government and institutional end users with an alternative to the incumbent local exchange carriers for a broad array of high quality voice, data, video transport and other telecommunications services.

As a result of the merger with Brooks Fiber Properties, each share of Brooks Fiber Properties common stock was converted into the right to receive 2.775 shares of WorldCom common stock or approximately 109 million WorldCom common shares in the aggregate. The merger with Brooks Fiber Properties was accounted for as a pooling-of-interests; and accordingly, our financial statements for periods prior to the merger with Brooks Fiber Properties have been restated to include the results of Brooks Fiber Properties.

BUSINESS

Following are descriptions of the businesses attributed to each of the WorldCom group and the MCI group. Although we are describing these businesses separately in order to give you a better understanding of the assets attributed to each group, the two groups are not separate legal entities.

The assets attributed to the WorldCom group include all of our network assets except voice switches, which are used to forward audio and data information from one point to another, and dial-up Internet modems, and also include cash, investments, buildings, furniture, fixtures and equipment, and the goodwill, other intangible assets, other long-term assets and other current assets associated with the businesses attributed to the WorldCom group. The assets attributed to the MCI group include voice switches, dial-up Internet modems and the goodwill, other intangible assets, other long-term assets and other current assets associated with the businesses attributed to the MCI group. For a further discussion of the assets attributed to the groups and the allocation methods used to allocate the assets, see the management's discussion and analysis of financial condition and results of operations, which is incorporated by reference herein.

Certain financial information about operations by segment and by geographic area for 1999, 2000 and 2001 is included in note 14 to our notes to our consolidated financial statements and is incorporated herein by reference.

WorldCom Group Operations

Overview

Our businesses attributed to the WorldCom group include:

- data services such as frame relay, asynchronous transfer mode and Internet protocol networks which provide a full spectrum of public and private network options for any data transmission requirement;
- Internet related services, including:
 - always-on connections to the Internet, which we refer to as dedicated access;
 - secure communication over the Internet allowing a business to link various sites and employees, which we refer to as a virtual private network;
 - high speed and always-on digital connections to the Internet, which we refer to as digital subscriber lines; and
 - web site management and web-enabled products which provide customers with the hardware, software and monitoring for their web sites;
- the design, implementation and ongoing management of a customer's communications system;
- commercial voice services; and
- international communications services

We believe we are positioned to utilize these global assets to provide traditional communications services, emerging e-commerce services, and WorldCom-provided managed or outsourced services to customers in major markets around the globe.

The businesses attributed to the WorldCom group accounted for 60.7% of our revenues, 101.7% of our net income and 88.4% of our assets for the year ended December 31, 2001. For the year ended December 31, 2000 the WorldCom group accounted for 58.2% of our revenues, 62.0% of our net income and 85.2% of our assets.

We have extensive networks that connect metropolitan centers and various regions throughout the world. As of December 31, 2001, our networks that connect metropolitan centers covered approximately 58,800 route miles, with an additional 10,900 route miles of local connections to customers worldwide. We also had over 2,500 centers where our equipment connects to the local phone company for call termination, which we call points of presence, 2,092 data switches, which forward information to its proper address, and connected 124 cities across North America, Europe, the Middle East, Africa, Latin America and Asia.

Using our Internet protocol infrastructure, we intend to continue our expansion into higher growth, next generation services, such as virtual private networks which use Internet protocol technology, web centers that allow customers to interact with sales and service agents over the Internet, the telephone or e-mail, and Internet content delivery services. We believe the breadth and scale of these services differentiate our offerings from those of our competitors and meet our customers' increasingly complex communications needs, highlighting the unique quality and reach of our networks.

We are positioning the company for leadership in the high growth segments of our industry. Our merger with Intermedia and resulting controlling interest in Digex provides us with a strong foothold in the managed hosting arena. Managed hosting services include providing the computer hardware, software, network technology and systems management necessary to offer customers comprehensive outsourced web site hosting solutions. We believe this position, combined with our extensive facilities-based network assets and corporate customer base, should create a strong competitor for e-commerce services and a platform for leadership in our target segments of U.S. and non-U.S. based corporations.

Industry

For several years, the communications industry has been undergoing a dramatic transformation due to several factors including:

- technological advances such as the Internet;
- rapid development of new services and products;
- the Telecommunications Act of 1996, or the Telecom Act;
- the deregulation of communications services markets in selected countries around the world; and
- the entry of new competitors in existing and emerging markets.

These are only a few of the forces impacting the communications industry today. However, each of these factors is driven by the rapid development of data services that are replacing traditional voice services. The development of frame relay, asynchronous transfer mode and Internet protocol networks has dramatically transformed the array and breadth of services offered by telecommunications carriers.

The use of the Internet, including intranets and extranets, which are private, secure communications networks, continues to grow, although at a slower pace than in recent years. Internet growth continues to be driven by a number of factors, including expanding availability of high speed or broadband access, improvements in network architectures and increasing numbers of network-enabled applications and devices. In spite of slower overall market growth, the Internet remains an important global communications and commerce medium. The Internet represents an opportunity for enterprises to interact in new and different ways with both existing and prospective customers, employees, suppliers and partners.

The market for data communications and Internet access and related products is characterized by rapidly changing technology, evolving industry standards, emerging competition and frequent new product and service introductions. We believe that the TCP/IP, where we use fiber optic or copper-based telecommunications infrastructure, will continue to be the primary protocol and transport

infrastructure **for** Internet-related services. TCP/IP combines two protocols, transmission control protocol and Internet protocol, to establish a connection between two devices **so** that streams of data can be sent between them. Session initiated protocols, or SIPs, are emerging as the basis for carrier-grade platforms from which enterprises will use SIP-enabled devices, such as "Internet telephones" to communicate within and outside the enterprise. Emerging transport alternatives include wireless cable modems and satellite delivery of Internet information. Alternative protocols, which are proprietary or allow systems using different formats to transfer data to communicate with each other, have been and are being developed. We are also participating in trials of next generation, more advanced technology.

Developments in technology are further increasing the capacity and lifespan of previously deployed fiber optic cables. Throughout 2002, we plan to continue to deploy high capacity broadband systems and fiber optic systems, both of which function to connect different networks, and long distance transmission systems which are not subject to signal deterioration. These network investments result in reduced regeneration requirements for long distance transmissions and higher bandwidth capacity from existing fiber optic cables which enhances our ability to serve global businesses cost effectively.

Strategy

Our objective is to use our strategic assets and customer base to be a leader in each of our target segments and deliver long-term sustainable growth. Key elements of our strategy include:

Target high growth data businesses: Our strategy is to focus primarily on higher growth and higher value-added data services that we can provide utilizing our extensive, high quality global networks. We believe this will decrease our reliance on traditional voice services, which have experienced pricing pressures in recent years.

Continue our focus on corporate enterprises: We are continually realigning our businesses with the customer bases they serve. We expect to further focus our resources, including assets, technical expertise and marketing skills, to better serve and grow our presence with corporate enterprise customers.

Rapidly deploy managed web hosting services: We plan to take advantage of the managed web hosting and data capabilities of Digex acquired through our merger with Intermedia. By combining Digex's comprehensive portfolio of hosting products with our extensive networks and customer relationships, we believe we will be able to strongly compete for e-commerce services.

Aggressively expand virtual private network services using internet protocol: Virtual private networks are private corporate communications networks and are often replacing or supplementing private line or frame relay networks **as** a cost effective and flexible solution for mid-sized and large corporate enterprises. We view this segment as a key contributor to our future growth and an integral part of our high-value service strategy. With our network capabilities, we intend to leverage the global reach and quality of our networks to capitalize on this higher growth and higher margin segment.

Maintain leadership in internet data transport and access: We plan to remain at the forefront of Internet protocol implementation worldwide. We expect Internet protocol services such **as** virtual private networks and e-business applications to proliferate and we plan to use our tradition of pioneering innovative Internet infrastructure services to expand our Internet value-added services.

Expand globally: We intend to leverage our global network capabilities by integrating existing platforms and deploying selected technologies. We believe this will allow **us** to expand product coverage while reducing costs. The net result to our customer is a portfolio of competitive products with global reach. We believe that international growth will continue.

Utilize our extensive networks: We plan to continue to utilize our networks to benefit our customers and reduce our costs. The global reach and quality of our networks enable us to provide complex services at low operating costs as a result of our facilities-based, on-net approach. The on-net approach allows our customers to send data streams or voice traffic locally, across the United States, or to any of our facilities-based networks in Europe, Africa or Asia, without ever leaving our networks. We believe this approach lowers our operating costs and provides our customers with superior reliability and quality of service. Our networks are **also** highly adaptable for future capacity expansions at lower per unit costs, and are designed to cost-effectively integrate future generations of optical-networking components to enhance efficiency and quality.

Description of Services

We provide a broad range of enhanced data and voice communications and managed network services through our direct commercial sales force of approximately 8,000 people. Core services include data services, Internet services, commercial local and long distance voice communications and international communications services.

Data Services

The ability of businesses to transmit data within their company or outside to business partners is a critical function today. Over the last 10 years, businesses made significant investments in software development and equipment purchases to effectively process and transmit this data and information. The Internet also introduced yet another means to communicate digitally worldwide.

We continue to make significant investments in network technologies to satisfy the continuing demand in high bandwidth data processing. Our global frame relay, asynchronous transfer mode and Internet protocol networks provide a full spectrum of public and private network options for any data transmission requirement. The ability to interconnect and to increase the bandwidth capacity of these networks protects customers' existing investments in established networks while taking advantage of the newest technologies.

Frame Relay: Frame relay is a high-speed communications technology that divides the information into frames or packets. Each frame has an address that the network uses to determine the destination of the frame. The frames travel through a series of switches within the frame relay network to arrive at their destination. This technology gives businesses a cost-effective, flexible way to connect local area networks, system network architecture, voice, and Internet protocol-based applications. Local area networks are computer networks which span a relatively small area and system network architecture is a protocol for connecting computers.

Our frame relay service, which is operated over our own facilities, is available in **46** countries and is supplemented by network-to-network interface partnerships that reach additional locations worldwide. These networks allow us to provide our customers around the globe with the highest quality standards of service.

Asynchronous Transfer Mode: Our on-net asynchronous transfer mode service is a technology and protocol structure that integrates data, voice, and video over a single communications network while offering a variety of access speeds and multiple service categories. Asynchronous transfer mode technology is able to service both the local area networks and wide area networks, which are computer networks spanning a large geographic area, providing scalability for users' current and future needs.

Our asynchronous transfer mode services use our highly redundant OC-48 backbone to obtain these networking advantages. OC-48 refers to a type of high speed optical carrier and backbone refers to the network connecting the system. These public data networking services offer a number of different access speeds and support multiple classes of service to meet customers' application needs.

The nature of the services provides **users** with the security and control of **a** private network, **plus** the flexibility and economies of **a** public network. Our asynchronous transfer mode services allow for the consolidation of applications into a single network service, reducing network, equipment and operational costs.

Data services revenue for 2001 grew by approximately 16.7% to \$8.6 billion, or 24.5% of WorldCom total revenues, versus \$7.4 billion, or 18.9% of WorldCom total revenues, for 2000 and \$5.8 billion, or 16.2% of WorldCom total revenues, for 1999.

Internet Services

As a leading Internet backbone provider, we offer **a** comprehensive range of Internet access and value-added options, applications and services tailored to meet the needs of businesses and other telecommunications providers. Our Internet products and services include dedicated Internet access, managed networking services and applications (such as virtual private networks), web hosting and electronic commerce and transaction services (such **as** web centers and credit card transaction processing).

Internet Access and Transport: Our Internet infrastructure is based on our OC-192c and OC-48c optical networks which use a combination of asynchronous transfer mode, frame relay and router technologies at the transport layer for both metropolitan and inter-regional connectivity. This network infrastructure enables customers to access the Internet through dedicated lines. Once connected, the customer's traffic is routed through our networks to the desired Internet location, whether on our networks or elsewhere on the Internet.

Through our networks, we offer the following access products to our customers:

- high speed T1/T3 connections;
- Internet gateway services which provide the hardware and software to link a customer's network to the Internet;
- frame relay to Internet protocol connections;
- asynchronous transfer mode to Internet protocol connections;
- digital subscriber line; and
- metropolitan area exchanges asynchronous transfer mode.

These access options provide the variety of bandwidth choices required for all business types and sizes.

*Virtual **Private** Networks:* We provide virtual private networks on public and shared environments for small and large customers. Our customers use virtual private networks to connect their corporate intranets, data centers, remote users, and the World Wide Web via the public Internet.

Our virtual private network service includes built-in encryption, bandwidth prioritization and 24-hour centralized management and monitoring services. Virtual private network services are already available in 26 countries, with continued expansion planned.

*Managed Hosting for **Business on the Internet:*** We are **a** leading managed hosting provider for businesses on the Internet. Our suite of services include:

- web site management services, such as operating and supporting Windows NT and UNIX based dedicated servers;

- application hosting services, such as application support for various operating systems, web servers, directory services, database servers, application servers and commerce suites;
- integrated business solutions, such as e-commerce, business intelligence and office solutions; and
- enterprise and professional services, such as fire wall management, stress testing, customized web site activity reporting and enhanced security service.

We deliver our services from geographically distributed, advanced Internet data centers that are connected to **our** dedicated and redundant Internet backbone network. **Our** tailored solutions are designed to integrate with existing enterprise systems architectures and to enable customers to outsource the monitoring, administration and optimization of their equipment, applications and overall Internet operations.

Through our controlling interest in Digex, we have been able to expand our web hosting by providing a comprehensive portfolio of hosting products and services for mid-sized and large businesses. These services enable businesses to more rapidly and cost-effectively deploy secure and reliable business solutions, including on-line financial services, on-line procurement, electronic retailing and customer self-service applications, to **our** customers over the Internet.

Internet services revenue for 2001 grew by approximately 28.7% to \$3.2 billion, or 9.0% of WorldCom total revenues, versus \$2.5 billion, or **6.3%** of WorldCom total revenues, for 2000 and \$1.6 billion, or 4.3% of WorldCom total revenues, for 1999.

Commercial local and long distance voice communications

We provide a single source for integrated local and long distance telecommunications services and facilities management services to businesses, government entities and other telecommunications companies.

The market for local exchange services consists of a number of distinct service components. These services include:

- local network services, which generally include basic dial tone and private line services;
- network access services, which consist of the local portion of long distance telephone calls; and
- long distance network services.

We also offer a broad range of related services that enhance customer convenience, add value and provide additional revenue sources. Advanced toll-free services offer features for caller and customer convenience, including a variety of call routing and call blocking options, customer reconfiguration, termination overflow to switched or dedicated lines, dialed number identification service, real-time automatic number identification and flexible after-hours call handling services.

Commercial local and long distance voice services revenues for 2001 were **\$6.6 billion**, or 18.7% **of** WorldCom total revenues, versus \$7.0 billion, or 18.0% **of** WorldCom total revenues, for 2000 and \$7.4 billion, or 20.7% of WorldCom total revenues, for 1999.

International Operations

Our global strategy is enabled by our position as an owner of telecommunications infrastructure throughout Europe, the Middle East, Africa, Asia Pacific and North America. **Our** international strategy is to use this foundation to design and deliver product sets and features globally so that multinational enterprises enjoy a consistency in service performance regardless of geography.

We provide switched voice, private line, and/or value-added data services over our own facilities and leased facilities in the United Kingdom, Germany, France, the Netherlands, Sweden, Switzerland, Belgium, Italy, Ireland, Luxembourg, Denmark, Finland, Hungary, Poland, Portugal, the Czech Republic, Greece, Israel, Austria, Norway and Spain. We operate metropolitan digital fiber optic networks in London, Paris, Frankfurt, Hamburg, Dusseldorf, Amsterdam, Rotterdam, Stockholm, Brussels, Zurich, Geneva, Dublin and Milan. We also offer international services over owned and leased facilities in selected Asian and African markets, including Australia, Japan, Hong Kong, Singapore, New Zealand, Indonesia, Malaysia, Thailand, Philippines, Taiwan, South Korea, China, India, South Africa, Botswana, Namibia, Kenya and Zambia. We were granted authority in the first quarter of 1998 to serve as a local and international facilities-based carrier in Australia and Japan and now operate metropolitan digital fiber optic networks in Sydney, Melbourne, Osaka and Tokyo. In early 2000 we were also granted a Type 1 license in Singapore, where we also operate a metropolitan digital fiber network.

Data centers are being deployed throughout Europe and Asia Pacific, interconnected with the global networks, allowing us to expand into new business areas using our worldwide telecommunications infrastructure as the platform for technology and service expansion.

Our equity investment in Embratel further extends our local-to-global-to-local strategy. Embratel's business consists principally of providing intra-regional long distance, inter-regional long distance and international long distance telecommunications services as well as data communications, text, Internet services and mobile satellite and maritime communications services. Embratel operates under a domestic long distance concession and an international long distance concession granted by Brazil's Agencia Nacional de Telecomunicações.

During the second quarter of 2001, we reached a long-term strategic decision to restructure our investment in Embratel. The restructuring included the resignation of certain Embratel board of directors seats, the irrevocable obligation to vote a portion of our common shares in a specified manner and the transfer of certain economic rights associated with such shares to an unrelated third party. Based on these actions, the accounting principles generally accepted in the United States prohibit the continued consolidation of Embratel's results. Accordingly, we have deconsolidated Embratel's results effective January 1, 2001.

Revenues from international operations for 2001 were approximately \$3.0 billion, or 8.5% of WorldCom total revenues, versus \$5.9 billion, or 15.0% of WorldCom total revenues, for 2000 and \$4.4 billion, or 12.2% of WorldCom total revenues for 1999. Excluding Embratel in the 2000 period, international revenues increased 25.8% from \$2.4 billion, or 6.7% of WorldCom total revenues for 2000.

Facilities

Networks

We own domestic long distance, international and multi-city local service fiber optic networks with access to additional fiber optic networks through lease agreements with other carriers. Additionally, we own and lease trans-oceanic cable capacity in the Atlantic and Pacific Oceans.

Deployed in business centers throughout the United States, Western Europe, the United Kingdom, Australia and Japan, our local networks are constructed using a closed loop which is referred to as ring topology. Transmission networks are based on optical network equipment. Network backbones and local networks are installed in rights-of-way owned by us or leased from third parties such as utilities, railroads, long distance carriers, state highway authorities, local governments and transit authorities. Lease arrangements are generally executed under multi-year terms with renewal options and are non-exclusive.

The long distance and local networks are protected by systems that are capable of restoring backbone traffic in the event of an outage in milliseconds. In addition, long distance and local switched traffic is dynamically rerouted via switch software to any available capacity to complete calls.

To serve customers in buildings that are not located directly on the fiber networks, we utilize leased T-3s, T-1s or local connections obtained from the traditional local phone companies, competitive local exchange carriers and other carriers who serve these buildings.

Our Internet infrastructure is based on our OC-192c and OC-48c optical networks which use a combination of asynchronous transfer mode, frame relay and router technologies to transport data.

We are deploying technology that integrates wide area networks for businesses with the public switched telecommunications network utilizing voice-over-Internet protocol gateways and session initiated protocol, which will provide businesses with a wide range of Internet voice and messaging services.

The WorldCom group is allocated an expense and the MCI group is allocated a corresponding decrease in depreciation expense for the use by the WorldCom group of the business voice switches attributed to the MCI group. The allocation is equal to a proportion, based on usage, of the MCI group's related costs. All other material transactions between the groups are intended to be on an arm's-length basis.

Internationally, we own or lease fiber optic capacity on most major international undersea cable systems in the Pacific and Atlantic Ocean regions. We also own fiber optic capacity for services to Eastern Europe, Asia, Central America, South America and the Caribbean. Furthermore, we own and operate 36 international gateway satellite earth station antennas, which enable us to extend public switched and private line voice and data communications to and from locations throughout the world.

Our network statistics, excluding Embratel, are as follows:

| | December 31, 1999 | December 31, 2000 |
|--|----------------------|----------------------|
| Domestic and international long distance route miles | 56,496 | 58,832 |
| Local domestic and international route miles | 10,153 | 10,937 |
| Voice grade equivalents | 65,537,123 | 76,415,566 |
| Buildings connected | 61,674 | 79,383 |
| Domestic telecom collocations | 417 | 531 |
| Facilities based cities | 123 | 124 |

Data Network Switching

Our asynchronous transfer mode networks utilize our intracity fiber connections to customers, asynchronous transfer mode switches and high-capacity fiber optic networks. Asynchronous transfer mode is a switching and transmission technology based on encapsulation of information in short (53-byte) fixed-length packets or "cells." Asynchronous transfer mode switching was specifically developed to allow simultaneous switching and transmission of mixed voice, data and video (sometimes referred to as "multimedia" information at various rates of transmission). In addition, characteristics of

asynchronous transfer mode switching allow switching information to be directly encoded in integrated circuitry rather than in software.

Our frame relay networks utilize our owned and maintained frame relay switches and **our** high-capacity fiber optic networks to provide data networking services to commercial customers. Networking equipment at customer sites connects to our frame relay switches which in turn are connected to each other via our extensive fiber optic networks. Frame relay utilizes variable length frames of data to transport customer data from one customer location across our networks to another customer location. Customers utilize the frame relay technology to support traditional business applications such as connecting local networks and financial applications.

Rates and Charges

Domestic and international business switched voice services originating in the United States are primarily billed in six-second increments; other rate structures bill in 18, **30** or 60 second increments. Switched voice services originating in international markets are billed in increments subject to local market conditions and interconnect agreements. Switched long distance services are billed in arrears, with monthly billing statements itemizing date, time, duration and charges. Local charges may be billed in **arrears** or in advance. Fixed recurring charges are billed in advance while metered charges are billed in arrears. Data services are generally billed a fixed rate per circuit and, depending on the service, a separate fixed network port charge. Data service rates are based on the speed of transmission, and depending on the service type, may be billed in arrears or in advance. Private line services are billed monthly in advance, with the invoice indicating applicable **rates** by circuit. Our rates are generally designed to be competitive with those charged by other long distance and local carriers.

Our Internet access products are sold in the United States and in many foreign countries for both domestic and global Internet services. Prices vary, based on service type. Due to various factors, such as available telecommunications technology, foreign government regulation and market demand, the service options offered outside of the United States vary **as** to speed, price and suitability for various purposes.

Sales and Marketing

We market our business communications services primarily through a direct sales force targeted at markets defined by both communications needs and geographies. Our commercial sales force **of** approximately 8,000 people, **also** provides advanced data specialization for the domestic and international marketplaces, including private line services.

Our **sales** force can be grouped primarily into three channels. The first targets small to large U.S.-centric enterprises in the U.S. The second addresses the same small to large enterprises outside the U.S. The third channel serves the largest 250 multinational corporations with a unified **sales** and service organization that mirrors the customers' own operations.

In each of our geographic markets, we employ **full** service support teams that provide our customers with prompt and personal attention. Our localized management, sales and customer support are designed to engender a high degree of customer loyalty and service quality.

Additionally, during 2001 we launched an online sales and support channel that complements our activities to reach smaller U.S.-based businesses. **This** web-based channel offers a suite of basic data and voice services in a cost-efficient manner.

Competition

The telecommunications industry is extremely competitive, and we expect that competition will intensify in the future. We face substantial competition in each of our business segments. Some **of** our

existing and potential competitors have financial and other resources significantly greater than ours. Moreover, some of these providers presently enjoy advantages as a result of their historic monopoly control over local exchange facilities. A number of traditional and emerging competitors have made significant investments in advanced fiber optic network facilities. In addition to voice and data competition from long distance service competitors, a number of facilities-based competitive local exchange carriers and cable television multi-system operators plan to offer local telecommunications services in major US cities over their own facilities or through resale of the local exchange carriers' or other providers' services.

Increasingly, we also must compete with equipment vendors and consulting companies in emerging Internet service markets. Companies have obtained or expanded their Internet-based services as a result of network deployment, acquisitions and strategic investments. We expect these acquisitions and strategic investments to increase, thus creating significant new competitors. Furthermore, we expect these firms to devote greater resources to develop new competitive products and services and to market those and existing products and services.

Overseas, we compete with new entrants as well as with incumbent providers, some of which still are partially government-owned, have special regulatory status along with the exclusive rights to provide services, and virtually all of which have historically dominated their local, domestic long distance and international services business. These incumbent providers enjoy numerous competitive advantages including existing facilities, customer loyalty, and substantial financial resources. We often must rely on facilities or termination services from these incumbent providers. We also compete with other service providers, some of which are affiliated with incumbent providers in other countries. We devote extensive resources to obtaining regulatory approvals necessary to operate overseas, and to obtain access to and interconnect with the incumbent's network on a non-discriminatory basis. In Europe, we compete directly with companies such as British Telecom, Deutsche Telekom, Cable & Wireless, France Telecom and Equant, global telecommunications alliances and with regional Internet service providers such as Terra and Oleana.

The development of new technologies and increased availability of domestic and international transmission capacity may also give rise to new competitive pressures. For example, even though fiber optic networks, such as those used by us, are now widely used for long distance transmission, it is possible that the desirability of these networks could be adversely affected by changing technology. The telecommunications industry is in a period of rapid technological evolution, marked by the introduction of new routing and switching technologies, new services, and increasing wireless, satellite and fiber optic transmission capacity for services similar to those provided by us. We cannot predict with certainty which of many possible future product and service offerings will help maintain our competitive position or what expenditures will be required to develop and provide these products and services. Nor can we predict whether spectrum rights that we hold will be affected by regulatory decisions to re-allocate spectrum for other uses, or whether current deployment plans for our multichannel multipoint distribution services will be sustainable if spectrum reallocation occurs.

Under the Telecom Act and ensuing federal and state regulatory initiatives, many barriers to local exchange competition are being eliminated. The introduction of competition, however, also establishes, in part, the ability of the traditional local phone companies to provide inter-LATA long distance services within a particular region. Local access and transport area, or LATA, refers to an area within a geographic region. To date, the FCC has granted applications by Verizon for the states of New York, Massachusetts, Pennsylvania, Connecticut and Rhode Island and by SBC for Texas, Kansas, Oklahoma, Missouri and Arkansas to provide in-region inter-LATA services. We believe the traditional local phone companies will continue to seek to enter these markets given their ownership of extensive facilities in their local service regions, their long-standing customer relationships and their very substantial capital and other financial resources. As the traditional local phone companies are allowed to offer in-region long distance services in additional states, they will be in a position to offer single source local and long

distance service similar, if not superior, to that being offered by **us**. We expect that increased competition will result in additional pricing and margin pressures in the domestic telecommunications services business. In addition, wireless carriers increasingly compete for consumers through nationwide or regional “bucket of minutes plans.” Indeed, wireless competition and the availability of inexpensive long-haul transport has already significantly reduced consumer long distance pricing, and as a result negatively affected the profitability of traditional service providers. As rates stabilize, we expect to compete effectively **as** a result of our innovation, quality and diversity of services, our ability to offer a combination of services, and our level of customer service.

As noted, we offer data communications and Internet-based services, including web hosting, collocation services, virtual private network services, dedicated and wholesale Internet access, and related services. This is **an** extremely competitive business and we expect that competition will intensify in the future. We believe that the ability to compete successfully in this arena depends on a number of factors, including:

- industry presence;
- the ability to expand rapidly;
- the capacity, reliability and security of network infrastructure;
- ease of access to and navigation on the Internet;
- the pricing policies of our competitors and suppliers;
- the timing of the introduction of new products and services by **us** and our competitors;
- our ability to support industry standards; and
- industry and overall economic trends.

Our success will depend heavily upon our ability to provide high quality data communications services, including Internet connectivity and value-added Internet services, at competitive prices.

Employees

Through our businesses attributed to the WorldCom group, we employed a total of approximately **61,800** full and part-time personnel, including Digex, as of February 28, 2002, approximately 400 of whom are represented by organized labor organizations. We consider our relationship with these employees to be good.

Patents, Trademarks, Tradenames and Service Marks

We actively pursue the protection of intellectual property rights in the United States and relevant foreign jurisdictions. **Our** continuing efforts have produced numerous issued patents and pending patent applications on innovative technology.

All tradenames, including the MCI tradename and the other related MCI tradenames, have been attributed to the WorldCom group. The MCI group will be allocated an expense and the WorldCom group will be allocated a corresponding decrease in depreciation and amortization expense for use of the MCI tradenames for the next four years based on the following schedule:

2002: \$30.0 million
2003: \$35.0 million
2004: \$40.0 million
2005: \$45.0 million

Any renewal or termination of use of the MCI tradename by the MCI group will be subject to the general policy that our board of directors will act in the best interests of WorldCom. For each of the years ended December **31**, 1999, 2000 and 2001, depreciation and amortization expense associated with the MCI tradenames allocated to the WorldCom group was decreased by \$27.5 million per annum for use of the MCI tradenames by the MCI group.

Regulation and Litigation

We are involved in legal and regulatory proceedings that are incidental to our business and have included **loss** contingencies in other current liabilities and other liabilities for these matters in our financial statements. In some instances, rulings by federal, state and international regulatory authorities may result in increased operating costs to **us**. The results of these various legal and regulatory matters are uncertain and could have **a** material adverse effect on our consolidated results of operations or financial position.

Regulation

We are subject to varying degrees of federal, state, local and international regulation. In the United States, our subsidiaries are most heavily regulated by the states, especially for the provision of local exchange services. Our subsidiaries must be certified separately in each state to offer local exchange and intrastate long distance services. No state, however, subjects **us** to rate of return regulation, nor are we currently required to obtain FCC authorization for installation or operation of our network facilities used for domestic services, other than licenses for specific multichannel multipoint distribution services, wireless communications service and terrestrial microwave and satellite earth station facilities that utilize radio frequency spectrum. FCC approval is required, however, for the installation and operation of our international facilities and services. **We** are subject to varying degrees of regulation in the foreign jurisdictions in which we conduct business, including authorization for the installation and operation of network facilities. Although the trend in federal, state and international regulation appears to favor increased competition, no assurance can be given that changes in current or future regulations adopted by the FCC, state or foreign regulators or legislative initiatives in the United States or abroad would not have a material adverse effect on us.

In August **1996**, the FCC established nationwide rules pursuant to the Telecom Act designed to encourage new entrants to compete in local service markets through interconnection with the traditional local phone companies, resale of traditional local phone companies' retail services, and **use** of individual and combinations of unbundled network elements, owned by the traditional local phone companies. Unbundled network elements **are** defined in the Telecom Act **as** any "facility or equipment used in the provision of **a** telecommunication service," as well **as** "features, function, and capabilities that are provided by means of such facility or equipment." In **January** 1999, the Supreme Court of the United States confirmed the FCC's authority to **issue** the rules, including **a** pricing methodology for unbundled network elements. On remand, the FCC clarified the requirement that traditional local phone companies make specific unbundled network elements available to new entrants. The traditional local phone companies have sought reconsideration of the FCC's order and have petitioned for review of the order in the United States Court of Appeals for the D.C. Circuit. That case is pending.

In its January 1999 decision, the Supreme Court remanded to the United States Court of Appeals for the Eighth Circuit various substantive questions concerning the FCC's rules for pricing unbundled network elements. In July 2000, the Eighth Circuit upheld the use of **a** forward-looking methodology but struck down the portion of the rule that calculates costs based on efficient technology and design choices. At the request of various parties, including **us**, the Supreme Court is reviewing the Eighth Circuit's decision. The Supreme Court heard oral argument in October 2001, and a ruling is expected in the first half of 2002.

In December 1999, the FCC concluded that in providing high-speed digital subscriber line services, the incumbent local phone companies should be required to share primary telephone lines with competitive local exchange carriers, and the FCC identified the high frequency portion of the loop as a network element. In January 2001, the FCC clarified that the requirement to share lines applies to the entire loop, even where the traditional incumbent local phone company has deployed fiber in the loop. Under the order, the incumbent local phone companies must permit competing carriers to self-provision or partner with a data carrier in order to furnish voice and data service on the same line. The incumbent local phone companies have appealed these two rulings and we have intervened in support of the FCC.

In December 2001 and February 2002, the FCC issued a series of Notices of Proposed Rulemaking, seeking to streamline and simplify the requirements imposed on traditional local phone companies with respect to unbundled network elements, broadband Internet access, and advanced services. Comments are due during the spring of 2002, and decisions are expected before the end of 2002. WorldCom cannot predict the outcome of these proceedings. However, if regulations are streamlined or removed, there are elements and combinations of elements upon which WorldCom relies to provide local services, broadband and advanced services that might no longer be required as a matter of federal regulation.

The Telecom Act requires traditional local phone companies to petition the FCC for permission to offer long distance services for each state within their region. Under section 271 of the Telecom Act, for these applications to be granted, the FCC must find, among other things, that the traditional local phone company has demonstrated that it has satisfied a 14-point competitive checklist to open its local network to competition and that granting the petition is in the public interest. To date, the FCC has rejected five traditional local phone company applications and it has granted ten: Verizon's for New York, Massachusetts, Connecticut, Pennsylvania and Rhode Island and SBC's for Texas, Kansas, Oklahoma, Missouri and Arkansas. WorldCom and other competitive carriers appealed to the D.C. Circuit the approvals for Kansas, Oklahoma and Massachusetts. On December 28, 2001, the D.C. Circuit decided that the FCC had not adequately addressed whether the prices charged for leasing network elements by SBC in Kansas and Oklahoma create a price squeeze which violated the standards for SBC to gain long distance approval. Without vacating the approval, the D.C. Circuit remanded the case to the FCC for it to address the price squeeze issue. A briefing schedule has not been established for the Massachusetts appeal. BellSouth has filed applications to offer long distance service for Georgia and Louisiana, and Verizon has filed applications for Vermont and New Jersey. Other applications may be filed at any time. We have challenged, and will continue to challenge, any application that does not satisfy the requirements of section 271 or the FCC's local competition rules. To date, these challenges have focused on the pricing of unbundled network elements and on the adequacy of the traditional local phone companies' operations support systems. In addition, legislation has been introduced in Congress that would have the effect of allowing traditional local phone companies to offer in-region long distance data services without satisfying section 271 of the Telecom Act and/or of making it more difficult for competitors to resell incumbent local phone company high-speed Internet access services or to lease the unbundled network elements used to provide these services. To date, WorldCom and others have successfully opposed these legislative initiatives.

In February 1999, the FCC issued a Declaratory Ruling and Notice of Proposed Rulemaking regarding the regulatory treatment of calls to Internet service providers. Prior to the FCC's order, over thirty state public utility commissions issued orders finding that carriers, including us, are entitled to collect reciprocal compensation for completing calls to Internet service providers under the terms of their interconnection agreements with traditional local phone companies. Many of these public utility commission decisions were appealed by the traditional local phone companies and, since the FCC's order, many traditional local phone companies have filed new cases at the public utility commissions or in court. We petitioned for review of the FCC's order in the D.C. Circuit, which vacated the order and

remanded the case to the FCC for further proceedings. In April 2001, the FCC issued an Order on Remand and Report and Order asserting jurisdiction over calls to Internet service providers and establishing a three-year transitional scheme of decreasing reciprocal compensation rates. We filed a petition for review of the FCC's order with the D.C. Circuit, and the Court heard oral arguments on February 12, 2002.

It is possible that spectrum rights held may be disrupted by FCC decisions to re-allocate some or all of that spectrum to other services. If this re-allocation were to occur, we cannot predict whether current deployment **plans** for our multi-channel multipoint distribution service services will be sustainable.

Litigation

In November 2000, class action complaints were filed in the United States District Courts for the Southern District of Mississippi, the Southern District of New York, and the District of Columbia against WorldCom and some of our executive officers. All of these actions were consolidated in the Southern District of Mississippi on March 27, 2001, along with another purported class action lawsuit filed on behalf of individuals who purchased stock in Intermedia between September 5 and November 1, 2000, which action asserts substantially similar claims and alleges that after the announcement of the WorldCom-Intermedia merger, the price of Intermedia stock was tied to the price of WorldCom stock. On June 1, 2001, the plaintiffs filed a consolidated amended complaint. Among other things, the consolidated amended complaint alleged that statements regarding WorldCom's revenues, the integration of MCI, the success of UUNET Technologies, and the expansion of WorldCom's network were false; WorldCom's financial disclosures were false; and WorldCom's announcement of its "generation d" initiative was misleading. Based on these allegations, the consolidated amended complaint asserts claims for violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and Section 20(a) of the Securities Exchange Act of 1934. The consolidated amended complaint seeks to certify a class of persons who purchased WorldCom shares between February 10, 2000 and November 1, 2000, inclusive; it does not assert separate claims on behalf of purchasers of Intermedia shares. On August 7, 2001, WorldCom and the individual defendants filed a motion to dismiss the consolidated amended complaint in its entirety. We believe that the factual allegations and legal claims asserted in the consolidated amended complaint are without merit and intend to defend them vigorously.

In August 1997, three complaints were filed in the United States District Court for the District of Columbia, as class actions on behalf of purchasers of MCI shares. The three cases were consolidated on April 1, 1998. On or about May 8, 1998, the plaintiffs in all three cases filed a consolidated amended complaint alleging, on behalf of purchasers of MCI's shares between July 11, 1997 and August 21, 1997, inclusive, that MCI and some of its officers and directors failed to disclose material information about MCI, including that MCI was renegotiating the terms of the MCI BT merger agreement. The consolidated amended complaint seeks damages and other relief. WorldCom and the other defendants have moved to dismiss the consolidated amended complaint.

MCI Group Operations

Overview

We provide a broad range of retail and wholesale communications services, including long distance voice and data communications, consumer local voice communications, wireless messaging, private line services and dial-up Internet access services. Our retail services are provided to consumers and small businesses in the United States. We are the second largest carrier of long distance telecommunications services in the United States. We provide services such as: basic long distance telephone service, dial around, collect calling, operator assistance and calling card services (including prepaid calling cards) and toll-free or 800 services to approximately 20 million residential and small business customers and over 470 carriers and other resellers. We offer these services individually and in combinations. Through combined offerings, we provide customers with benefits such as single billing, unified services for multi-location companies and customized calling plans. Our wholesale businesses include wholesale voice and data services provided to carrier customers and other resellers, and dial-up Internet access services.

Our management's goal is to use our existing market positions and assets opportunistically to optimize cash flow, while paying dividends and retiring the debt attributed to the MCI group. Available cash flow, after dividend payments, will be available for debt repayments and possible share repurchases. The businesses attributed to the MCI group have significant assets, including the nationally recognized brand, extensive customer relationships, 19 call centers with highly effective sales representatives and a tradition of developing innovative calling plans that enhance customer retention. Management believes it can leverage these strengths to deliver new services and to bundle existing services.

The businesses attributed to the MCI group accounted for 39.3% of our revenues, (1.7)% of our net income and 13.4% of our assets for the year ended December 31, 2001. For the year ended December 31, 2000, the MCI group accounted for 41.8% of our revenues, 38.0% of our net income and 14.8% of our assets.

Industry

The communications services industry continues to change both domestically and internationally, providing significant opportunities and risks to the participants in these markets. In the United States, the Telecom Act significantly impacted our business by establishing a statutory framework for opening the U.S. local service markets to competition and by allowing the traditional local phone companies to provide in-region long distance services. In addition, prices for long distance minutes and other basic communications services declined as a result of competitive pressures, the introduction of more efficient networks and advanced technologies, product substitution, and deregulation. Competition in these segments is based more on price and less on other differentiating factors that appeal to the larger business market customers including: range of services offered, bundling of products, customer service, and communications quality, reliability and availability.

The wholesale business is currently undergoing a similar transformation. The decreasing number of switchless long distance resellers combined with the intense competition has led to significant price declines and margin pressure.

The consumer and small business long distance segment is characterized by rapid deregulation and intense competition among long distance providers, and more recently, traditional local phone companies. Under the Telecom Act, traditional local phone companies may offer long distance services in a state within its region if the FCC finds first, that the traditional local phone company's service territory within the state has been sufficiently opened to local competition and second, that allowing the traditional local phone company to provide these services is in the public interest. We have

challenged, and will continue to challenge, any application that does not meet the criteria envisioned by the Telecom Act or the related rules relating to local competition issued by the FCC.

Strategy

Because of changes in the communications industry, our objective is to leverage the assets attributed to the MCI group and our established market presence to maximize cash flow returns from our mature businesses attributed to the MCI group. With respect to the businesses attributed to the MCI group we intend to:

Optimize resources: We intend to focus our strategies on enhancing margins and cash flow. We expect to be opportunistic and undertake only those initiatives that can generate cash flow without significant capital commitment.

Leverage MCI brand: The internationally recognized MCI brand will be an important component of our marketing initiatives.

Leverage marketing channels: We intend to enhance the utilization of our existing telemarketing centers and mass-market distribution channels to grow our customer base, enhance customer retention and expand our consumer product offerings.

Expand local services: We have entered local communications markets in New York, Pennsylvania, Texas, Illinois, Michigan, Georgia, California, Florida and Ohio and will selectively evaluate similar opportunities.

Improve operations support systems and automation: We intend to continue to improve operations support systems and increase automation to improve efficiency, enhance customer service and develop a platform for more value-added services.

Continue to leverage advanced network: We intend to continue to leverage WorldCom's extensive, advanced and scaleable fiber optic networks to provide differentiated services at competitive rates.

Description of Services

The MCI group's services include long distance voice communications, local voice communications, wireless messaging and other services, wholesale communications services as well as dial-up Internet access. We believe that our assets attributed to the MCI group, including the call centers, sales representatives, customer relationships and our significant marketing skills will allow us to expand our products and services to our existing consumer base without significantly increasing capital spending.

Long Distance Voice Communications

We are the second largest provider of long distance telecommunications services in the United States, including consumer, small business and wholesale. We offer domestic and international voice services, including basic long distance telephone, dial around, collect calling, operator assistance and calling card (including prepaid cards), 800 services, and directory services. Long distance voice services are offered individually or combined as a bundle with other services such as local voice services. Our market position in the long distance voice segment is sustained by our telemarketing and other marketing channels and marketing support for the MCI brand. In the year ended December 31, 2001, we provided 94.7 billion minutes of service compared to **104.4** billion in 2000 and 92.9 billion minutes in 1999. **For** the year ended December 31, 2001, long distance services, including consumer, small business, wholesale and alternative channels, provided \$10.2 billion of revenues, or 28.9% of WorldCom total revenues, versus \$12.4 billion of revenues, or 31.7% of WorldCom total revenues, for 2000 and \$12.6 billion of revenues, or 35.0% of WorldCom total revenues, for 1999.

Consumer Local Voice Communications

We are aggressively, yet prudently expanding our local service and we have selectively entered local exchange markets, including New York, Pennsylvania, Texas, Illinois, Michigan, Georgia, California, Florida and Ohio. We provide local **toll** and switched access services to residential and small business customers, typically through our **own** switches and through unbundled network elements leased from traditional local phone companies. We usually lease the underlying traditional local phone company network elements as a bundle, consisting of seven elements, most notably the local wire to the customer, the switch equipment, and call switching. We pay the traditional local phone company a monthly fee for the local wire to the customer and switch equipment and a per-minute fee for switching. This mode of service delivery enables **us** to lower the cost of providing call origination **as well as** providing **us** with call termination revenue. For those customers who subscribe for both local and long distance services, we offer an “all-distance” calling plan that bundles the services at an attractive price for the customer and enhances customer retention.

As of December 31, 2001, we had a total of 1.5 million local exchange customers. Approximately 83% of our local exchange customers **also** subscribe **to our** long distance service. The consolidated local and long distance subscribers deliver three times the lifetime revenue of standalone long distance customers due to much higher monthly spending and lower subscriber chum. We estimate that our market share in New York is 7%, Pennsylvania and Texas are 5%, Illinois is 6%, Michigan is 9% and Georgia is 4% and local service in California, Florida and Ohio each generated less than 1% of market share. Additionally, we are able to reach 41% of all U.S. households in RBOC territories. For the year ended December 31, 2001, consumer local services provided \$500 million of revenue, or 1.4% of WorldCom total revenues, versus \$179 million, or 0.5% of WorldCom total revenues, for 2000 and \$41 million, or 0.1% of WorldCom total revenues, for 1999.

Dial-up Internet Access

Our dial-up Internet access business primarily serves consumer-oriented Internet service providers that are accessed via dial-up modems. New technologies, including dedicated access provided by carriers, and increased competition have caused significant price declines. Although we believe we are well positioned in this segment due **to** the strength of our extensive customer relationships and the scale of our networks, we expect pricing pressure to continue to negatively affect our business.

As of December 31, 2001, we managed 3.2 million modems versus 2.8 million modems **as** of December 31, 2000. In addition, we provided 7.1 billion hours of Internet access for the year ended December 31, 2001 versus 6.5 billion hours for 2000 and 4.2 billion hours for 1999. **For** the year ended December 31, 2001, dial-up Internet access services provided \$1.5 billion of revenue, or 4.4% of WorldCom total revenues, versus \$1.6 billion, or 4.2% of WorldCom total revenues, for 2000 and \$1.5 billion, or 4.2% of WorldCom total revenues, for 1999.

Wholesale Data Services

Our wholesale data services consist primarily of the sale of private lines to earner customers. This service experienced significant pricing pressure due largely to the entry of new competitors and the **build-out of facilities** by our customers allowing them to provide more services over their own facilities.

We anticipate that wholesale data services will increasingly become a smaller percentage of total revenues as we focus on providing services to end-customers rather than competitive carriers. For the year ended December 31, 2001, wholesale data services, including wholesale alternative channels, provided \$1.2 billion of revenue, or 3.3% of WorldCom total revenues, versus \$1.4 billion, or 3.7% of WorldCom total revenues, for 2000 and \$1.5 billion, or 4.2% of WorldCom total revenues for 1999.

Wireless Messaging

We provide and market our paging services through SkyTel Communications, Inc., a leading provider of wireless messaging services in the United States and a wholly owned subsidiary of WorldCom. ~~As~~ of December 31, 2001, SkyTel had approximately 1.1 million units in service in the United States which included approximately 600,000 domestic one-way units and 540,000 advanced messaging units. For 2001, these services provided \$441 million of revenue, or 1.3% of WorldCom total revenues, versus \$549 million, or 1.4% of WorldCom total revenues, for 2000 and \$470 million, or 1.3% of WorldCom total revenues. for 1999.

Facilities

Our long distance voice switches have been allocated to the MCI group. Domestic long distance services are provided primarily over the fiber optic communications systems attributed to the WorldCom group. To a lesser extent, we will continue to utilize transmission facilities leased from other common carriers. International communications services are provided by submarine cable systems in which WorldCom holds positions, satellites and facilities of other domestic and foreign carriers.

Long distance voice services are provided by long distance voice switches using circuit switched technology. Voice switches are interconnected together and provide standard long distance voice services as well as a variety of value-added services. To reduce capital investment in circuit switches, we are deploying softswitches ~~to~~ process Internet dial-up access *independent* of our circuit switches. The softswitches are general-purpose based computer systems which route calls directly to the public Internet.

Our dial-up Internet access network consists of equipment and network configurations all generally designed to terminate inbound Internet data calls from end users. Generally, the equipment consists of network access servers, which are general purpose computing devices containing concentrated quantities of digital modems. The equipment in off-net locations is, in many cases, owned and operated by the traditional local phone company pursuant to service arrangements. The remaining equipment is owned and maintained in our own facilities ~~or~~ in leased co-location facilities.

The MCI group is allocated an expense and the WorldCom group is allocated a corresponding decrease in depreciation and amortization expense for the use by the MCI group of the fiber optic systems and buildings, furniture, fixtures and equipment attributed to the WorldCom group. The expense is equal to a proportion, based on usage, of the WorldCom group's related costs. All other material transactions between the groups are intended to be on an arm's-length basis.

Most of our customers access their services through local interconnection facilities provided by the traditional local phone companies. We utilize unbundled network elements to provide local services in New York, Pennsylvania, Texas, Illinois, Michigan, Georgia, California, Florida and Ohio. ~~As~~ we expand in other markets upon deregulation and market evaluation, we expect to continue to utilize unbundled network elements to offer local communications services.

Collectively, we own 19 call centers, which range in size from 40,000 square feet to over 100,000 square feet.

Rates and Charges

We charge switched customers on the basis of a fixed rate per line **plus** minutes or partial minutes of usage at rates that **vary** with the distance, duration and time of day of the call. For local service, customers are billed a fixed charge **plus usage** or flat rated charges depending on the plan chosen by the customer. The rates charged are not affected by the particular transmission facilities selected by **us**. Additional discounts are available to customers who generate higher volumes of monthly usage. Our dial-up Internet access prices vary based on service type.

Sales and Marketing

We believe our sales and marketing capabilities are one of our strongest competitive advantages. Telemarketing is a fundamental component of the sales effort for residential and small business customers. Typically, over 50% of our residential and small business installations are sold through some 7,700 telemarketers based in 19 call centers nationwide. Our marketing partners, in turn, are a key competitive advantage for differentiating long distance sales, offering consumers the opportunity to earn frequent flyer miles, free video rentals, and similar awards based on long distance usage. Over **46%** of subscription long distance minutes are generated by our 6.2 million partner customers.

We **also** increased our market share among high spending international callers through broad-based marketing efforts. Moreover, we have successfully launched branded transaction products such as "10-10-220" and "1-800-Collect." Our industry leading "10-10-220" product provides a unique way for customers to save on every call and helps maintain strong brand recognition.

Alternate marketing channels include direct sales agents and prepaid card distribution. There are over 400 sales agents throughout the United States marketing to consumers and small businesses through marketing groups. We retain a leading position in the prepaid calling card market **as** well.

Through our direct sales force, we market various services to resellers including customers such **as** Verizon. We are a leader in the dial-up Internet access market segment with **all** major Internet service providers as wholesale customers, including, among others, **AOL**, Earthlink, and MSN.

Competition

The telecommunications industry is extremely competitive, and we expect that competition will intensify in the future. In each of our business segments, we face intense competition from other service providers. The primary competitors in the domestic and international consumer segments are AT&T, Sprint and, where they are permitted to offer in-region long distance service, Verizon and **SBC**. We **also** compete against other facilities-based long distance providers, such **as** Qwest. The traditional local phone companies presently have numerous advantages **as** a result of their historic monopoly control over local exchanges, and some of our existing and potential competitors have financial and other resources significantly greater than **ours**. A continuing trend toward business combinations and alliances in the telecommunications industry may create significant new competitors.

Under the Telecom Act and ensuing federal and state regulatory initiatives, many barriers to local exchange competition are being eliminated. The introduction of competition, however, **also** establishes, in part, the ability of the traditional local phone companies to provide inter-LATA long distance services. To date, the FCC granted applications **by** Verizon **for** the states of New York, Massachusetts,

Pennsylvania, Connecticut and Rhode Island and by SBC for Texas, Kansas, Oklahoma, Missouri and Arkansas to provide in-region inter-LATA services. We believe the traditional local phone companies will continue to seek to enter these markets given their ownership of extensive facilities in their local service regions, their long-standing customer relationships and their very substantial capital and other financial resources. **As** the traditional local phone companies are allowed to offer in-region long distance services in additional states, they will be in a position to offer single source local and long distance service similar, if not superior, to that being offered by **us**. We expect that increased competition will result in additional pricing and margin pressures in the domestic telecommunications services business. In addition, wireless carriers increasingly compete for consumers through nationwide or regional "bucket of minutes plans." Indeed, wireless competition and the availability of inexpensive long-haul transport has already significantly reduced consumer long distance pricing, and **as** a result negatively affected the profitability of traditional service providers. As rates stabilize, we expect to compete effectively as a result of our innovation, quality and diversity of services, our ability to offer a combination of services, and our level of customer service.

We expect increased competition from providers determined to exploit technologies which may reduce the cost of providing services. We are working to develop these services and expect to be at the forefront of these technological developments and to leverage them to protect and grow market share, to increase revenues and profitability, and to retain customers.

We **also** face intense competition in offering wholesale services, small business services, dial-up Internet, and paging and prepaid calling card services. In wholesale services, we compete directly with traditional network access providers such **as** AT&T and Sprint. We obtain network capacity from our businesses attributed to the WorldCom group and provide wholesale service to other carriers in competition with a variety of facilities-based carriers. There can be no assurance that we will continue to be successful in this segment. In the small business customer segment, we compete against traditional local phone companies and numerous other competitive carriers offering local services, long distance services, or both. Other carriers, particularly competitive local exchange carriers, are aggressively pursuing this segment of the market. Our paging business competes directly with traditional one-way paging providers, and recently experienced significant competition and product substitution from other advanced wireless data service providers, including two-way paging services providers and wireless service providers. Prepaid calling cards are **also** in an intensely competitive segment where many carriers resell cheaper aggregated international minutes through this medium and where wireless products **are** further compressing pricing.

Employees

Through our businesses attributed to the MCI group, we employed a total of approximately **23,200** full and part-time personnel **as of February 28, 2002** none of whom are represented by organized labor unions. We consider our relationship with these employees to be good.

Patents, Trademarks, Tradenames and Service Marks

All tradenames, including the MCI tradename and the other related MCI tradenames, have been attributed to the WorldCom group. The MCI group will be allocated **an** expense and the WorldCom group will be allocated **a** corresponding decrease in depreciation and amortization expense for the use of the MCI tradenames for the next four years based on the following schedule:

| | |
|--------------|-----------------------|
| 2002 | \$30.0 million |
| 2003: | \$35.0 million |
| 2004: | \$40.0 million |
| 2005: | \$45.0 million |

Any renewal or termination of use of the **MCI** tradename by the **MCI** group will be subject to the general policy that our board of directors will act in the best interests of WorldCom. For each of the years ended December 31, 1999, 2000 and 2001, an expense of \$27.5 million per annum was allocated to the **MCI** group for use of the **MCI** tradenames.

Regulation and Litigation

We are involved in legal and regulatory proceedings that are incidental to our business and have included **loss** contingencies in other current liabilities and other liabilities for these matters in our financial statements. In some instances, rulings by federal and state regulatory authorities may result in increased operating costs to **us**. The results of these various legal and regulatory matters are uncertain and could have a material adverse effect on **our** consolidated results of operations or financial position. See the information contained in “Item 1. ~~Business~~—**Business**—WorldCom group Operations—Regulation and Litigation,” which is incorporated by reference herein, for a discussion of regulation and litigation matters.

ITEM 2. PROPERTIES

The information contained in “Item 1. ~~Business~~—**Business**—WorldCom group Operations—Facilities” and “~~MCI~~ group Operations—Facilities” is hereby incorporated by reference.

ITEM 3. LEGAL PROCEEDINGS

We are involved in legal and regulatory proceedings generally incidental to our business. In some instances, rulings by federal and some state regulatory authorities may result in increased operating costs to us. ~~As~~ indicated above in Item 1. Business or in note 9 to our notes to consolidated financial statements, which are incorporated herein by reference, the results of these various legal and regulatory matters are uncertain and could have a material adverse effect on our consolidated results of operations or financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None